



# COMMODITY CUSTOMER COALITION

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February 15, 2013

Via Website  
Ms. Sautia Warfield  
Assistant Secretary  
Commodity Futures Trading Commission  
1155 21st Street NW  
Washington DC 20581

**RE: Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivative Clearing Organizations Proposed Customer Protection Rules (RIN 3038-AD88)**

Dear Ms. Warfield:

The Commodity Customer Coalition ("CCC") respectfully submits this letter in response to the request of the Commodity Futures Trading Commission ("CFTC") for comments on its proposed rules for Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivative Clearing Organizations ("Proposed Rules"). The CCC is a 501(c)(4) non-profit organization, which formed in response to the bankruptcy of commodity broker MF Global. The CCC represents commodity customers in the bankruptcy proceedings of MF Global and PFGBest. We also provide guidance and support for these customers as they seek the return of their property. We are engaged in several reform efforts, including a private opt-in insurance mechanism for commodity customers, a pilot program testing alternative methods of collateral segregation, revisions to the Commodity Exchange Act ("CEA") and various updates to the Bankruptcy Code.

We would like to thank the CFTC for its efforts to enact new and revise existing rules in order to strengthen protections afforded to commodity customers. The CCC particularly appreciates the contemplative, open and transparent rule making process the CFTC has undertaken, as well as the CFTC's willingness to hear comments from all corners of our global industry.

While we applaud the efforts and intent behind the Proposed Rules, many of them would increase the risk of FCM insolvency, increase the magnitude of FCM insolvency by vastly increasing concentration risk and require commodity customers to greatly increase the capital they tender to their FCM to margin their positions. The malfeasance of some FCMs should not be corrected by asking commodity customers to provide more money to every FCM with which they do business.

Therefore the CCC respectfully requests that the CFTC refrain from implementing the Proposed Rules so that it can work more closely with industry constituents on their revision, as well as other means to achieve the goals of the Proposed Rules.

## **Maintenance of Residual Interest in Excess of All Margin Deficiencies Exposes Even More Customer Property to Insolvency Risk**

The relevant portions of the Proposed Rules surrounding residual interest indicate to the CCC that the CFTC has the commendable goal of making explicit the requirement that customer property must be held segregated at all times of the day. While many in the industry see the changes in residual interest requirements as nothing more than an attempt to address fellow customer risk, the CCC believes the CFTC is trying to address the risk that an FCM may exploit end of day balancing and reporting to use customer collateral intraday for proprietary purposes.

It is our understanding that MF Global employed a strategy in which they used collateral beyond the firm's residual interest in 4(d) segregated accounts to meet proprietary liquidity needs of the firm. MF Global had a legal rationale that if that collateral was repaid to the segregated accounts by the end of each day, it was in full compliance with the segregation requirements of the CFTC and CEA. While the requirement of segregation to be maintained 'at all times' is certainly implicit in the CEA, the operational realities of computing those segregation requirements exposes customer funds to misuse by FCMs who may exploit the lag in reporting to benefit from customer property for proprietary purposes.

Regardless of the CFTC's intent, the relevant portions of the Proposed Rules go beyond regulating the intraday use of the pool of customer property. The Proposed Rules ignore the operational complexity of an FCM and delve deeply into the mediation of credit between the FCM and its customers. While the new requirements for maintenance of residual interest are aimed at the FCM, the practical effect is that FCMs would require commodity customers to contribute significantly more property to their FCM in order to meet new margin requirements far in excess of exchange margin requirements.

The CCC represents thousands of customers ensnared by the insolvencies of MF Global and PFGBest. While these customers support efforts to strengthen customer segregation rules, oversight and practices, they are wary of any solution which would require them to contribute even more capital to a system they believe is flawed. Rough estimates regarding the additional capital FCMs may require of customers if the Proposed Rules go into effect range from an additional \$40 to \$80 billion. Customers would be better served by retaining that capital outside the custody of their FCM in order to use it to mitigate the impact of the insolvency of their FCM. If that capital resides within the control of the FCM, it is available

## **Requiring Capital Charges for T+1 Margin Calls Raises Risk of FCM Insolvency**

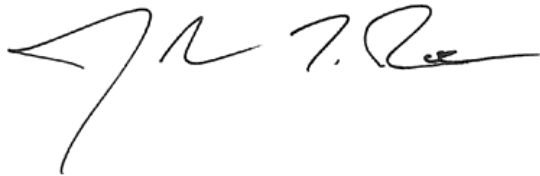
If the Proposed Rules are implemented, the relevant portions requiring an FCM to take capital charges on margin calls older than one day places an undue burden on the FCM, which in turn will negatively impact commodity customers. FCMs will likely require pre-funding of trades to prevent margin calls from taking place and this could increase the likelihood of forced liquidation of positions by FCMs in order to prevent capital charges.

Moreover, there are many potential scenarios in which the application of the Proposed Rules with respect to margin calls may increase the risk of shortfalls in customer property. For example, during periods of highly volatile markets in which assets are correlated, as in events like the Japanese Tsunami of 2011, rapid fluctuations in market prices could render an FCM insolvent under the Proposed Rules. Margin calls across the FCM customer book older than one day could result in negative net capital for that FCM.

Disclosure of that negative net capital could result in a liquidity stress event which may lead to a 'run on the bank' and FCM insolvency. This is just one potential scenario in which unintended consequences of this rule could result in an FCM community which is less competitive and less protective of customer assets.

For these and other reasons, CCC recommends that the CFTC refrain from implementing the Proposed Rules at this time. We are aware that other comment letters suggest that the CFTC undertake a cost-benefit study to determine the consequences and operational impact of the Proposed Rules. The CCC supports such a study and hopes the CFTC will consider conducting it.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "JL Roe". The signature is fluid and cursive, with a large initial "J" and "L" followed by "Roe".

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